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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 008545

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SENSITIVE

STATE FOR EUR/SE, EB/IFD/OMA, AND E
TREASURY FOR OASIA - MILLS AND LEICHTER
STATE PASS USTR - NOVELLI AND BIRDSEY

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TAGS: ECON EFIN PREL TU

SUBJECT: TURKISH MARKETS REACT TO COURT'S SUSPENSION OF KEY
REGULATORY ACTION; IMF PLANS FOR ENGAGING THE NEW
GOVERNMENT

REF: ANKARA 8527

Classified by Econ Counselor Scot Marciel for reasons 1.5
(b,d).

Negative Development on Banking Reform

11. (U) On November 22, Turkish press reported that Turkey's supreme administrative court ("Danistay") issued a decision to suspend the Bank Regulation and Supervision Agency's (BRSA) intervention of the insolvent Pamukbank. Under Turkish law, the bank will now be handed back to its former owner Cukurova Holding (also the controlling shareholder of Yapi Kredi Bank), pending final resolution of the court case. We contacted BRSA staff, but they like us had only seen press reports and refrained from comment.

12. (U) Pamukbank was taken over by BRSA on June 19, following independent bank audits which revealed a capital deficiency of about \$2 billion. Presumably, Cukurova Holding will now be given a second chance to recapitalize the bank (and repay the BRSA for funds it has injected after taking over the bank); if it cannot do so (as it couldn't in June), presumably the bank will be returned to the BRSA. The court's suspension of Pamukbank intervention will also affect the fate of sister Yapi Kredi Bank, since Pamuk had owned 10 percent of Yapi's shares, which together with other Pamuk assets had been transferred to the BRSA.

13. (U) Initial market reaction to the court decision was negative: the lira depreciated 0.75 percent (to TL 1,590,000 per dollar), and T-bill yields rose about 1 percentage point (to 52.5 compounded). JP Morgan/Chase treasurer told us at mid-day that the initial damage appeared to be limited, "but if this becomes a deal-breaker for the IMF, watch out."

IMF Plans

14. (C) Earlier in the day, IMF resrep (protect) briefed us on plans to engage the new GOT. In a long meeting November 21 evening with State Minister Babacan, resrep pushed for the IMF mission to begin right after the end of the Ramadan holiday, on December 9, and continue for two weeks. The mission would be preceded by a December 2-4 visit to Ankara by IMF Europe Director Deppler and Mission Chief Kahkonen, to meet the new ministers. After checking with PM Gul, Babacan accepted this plan. IMF resrep believes that a further IMF mission will be needed in early January to wrap up the Fourth Review (which includes reaching agreement on 2003 macro targets).

15. (C) IMF resrep said his instructions were to tell Babacan that three elements of the program were "non-negotiable": the 6.5 percent of GNP primary budget surplus; BRSA independence; Central Bank independence. On BRSA independence, IMF resrep added that there was "an important test case in the Fourth Review" (resolution of Yapi Kredi's ownership). He said that Babacan replied, "we've discussed this case and it will not be a problem." (Note: This was before the November 22 Danistay decision.)

Comment

16. (C) Today's decision on Pamukbank, if not reversed, will create new uncertainties in the market, and increase risks in the banking system. We still need to learn details of the court decision. But a senior banker, Kocbank CEO Karacaham, told us he believes Cukurova Holding will try to recapitalize Pamukbank (and perhaps Yapi Kredi) by revaluing shares in the group's telecom company Turkcell, held by the banks as collateral for loans to their owner. Such a ploy would leave two large unhealthy players in the banking system, who would find it difficult to borrow internationally, and could present a large fiscal risk to the GOT. These two banks' combined deposits (100 percent guaranteed by the government) are over \$10 billion.

17. (C) The new government's commitment to banking reform will come under heightened scrutiny, in light of criticism of the BRSA by AK during the campaign and this decision to roll back a key regulatory action.

PEARSON